



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE Division, EO Grp 7983
9350 Flair Dr. 2nd Floor
El Monte, CA 91731-2885

April 2, 2008

Number: 201318014
Release Date: 5/3/2013

ORG
ADDRESS

UIL: 501.04-00

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

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| Form 886A | Department of the Treasury - Internal Revenue Service Explanation of Items | Schedule No. or Exhibit |
| Name of Taxpayer ORG EIN | | Year/Period Ended 12/31/20XX, 12/31/20XX |

LEGEND

ORG - Organization name XX - Date EIN - EIN Address - address
City - city State - state POA - poa President - president
Treasurer - treasurer Secretary - secretary CEO - CEO BM-1 through
BM-6 - 1st through 6th BM CO-1 through CO-7 - 1st through 7th COMPANIES

Issue:

Whether ORG (ORG) was operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(4):

- Whether ORG is engaged primarily in activities that accomplish an exempt purpose?
- Whether more than an insubstantial part of ORG's activities is in furtherance of a non-exempt purpose?
- Whether ORG was operated for the purpose of serving a private benefit rather than public interests?

Facts

Background of ORG:

ORG (ORG), with Employer Identification Number ("EIN") EIN, was initially incorporated in the State of State on March 26, 20XX. The specific purpose of the corporation was to provide credit counseling and debt management services.

ORG initially filed Form 1023, *Application for Recognition of Exemption under Section 501(c) (3) of the Internal Revenue Code*, for the Service to make a determination whether ORG meets the public support test under IRC 509(a)(2). The application was signed by POA, CPA as Power of Attorney. ORG described its activities and operational information on page 2 of Form 1023 as and hereby quoted:

"The Organization's proposed program activities will consist of debt management services to be offered to needy individuals without regards to race, sex, creed or national origin. The debt management program activities will entail one hundred percent of the organization's time.

(A) Detailed Description of the Activity:

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The Organization will offer debt management services to needy individuals based on the biblical concepts of money management. These services will include:

Counseling needy individuals on best practices designed to retire excessive debt balances in a systematic and rational way.

The preparation of a personal budget for the purpose of redrafting debt payments and submission to creditors.

Negotiating with the creditors a new debt retirement schedule on the basis of the prepared personal budgets.

Implementing a payment plan, once the creditors' agreement has been secured, wherein funds from these needy individuals will be collected, placed in a separate trust escrow account and then remitted to the creditors as per the previously arranged payment plans with the respective creditors.

How activity furthers exempt purpose:

The organization was formed for the specific purpose to promote and improve the health, education and welfare of needy individuals by providing credit counseling and debt management services. By assisting individuals get out of debt in a rational and systematic fashion, the organization will be improving the welfare of these persons and possibly keep them from bankruptcy and/or financial ruin. By educating them in the biblical teachings of money management, the persons benefited may avoid similar financial crisis in the future.

(B) When the activity will be initiated:

The activities are expected to commence June 1, 20XX.

(C) Where and by whom the activity will be conducted:

The activity will be conducted primarily in the State of State by CO-1."

The officers and directors listed on the Form 1023 were President, CEO, President and Director; Treasurer, Treasurer and Director and Secretary, Director, Secretary and Chief Operating Officer.

A copy of the unexecuted copy of bylaws was provided along with its Form 1023 application submission. However, during the course of the determination application

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processing, the determination specialist requested ORG to revise its Form 1023 to a Form 1024 under Civic Leagues, social welfare organizations. On June 23, 20XX, the Service issued the determination exemption letter to ORG as an IRC 501(c)(4) organization.

Minutes:

For the years under examination, ORG provided annual meetings conducted for the years 20XX, 20XX and 20XX. The minutes were signed by Treasurer. These minutes indicated Treasurer as secretary of ORG. The board members presented, as stated in the minutes, were Treasurer, BM-1, BM-2, BM-3 and BM-4.

For the minutes, dated January 27, 20XX, under the heading for Chief Executive's Report and hereby quoted:

"Treasurer reported that the number of individuals benefited by the Organization was continuing to decline. Among other factors discussed, changes that occurred in the 20XX state of State debt management legislation combined with the unique nature of the Organization's clientele was making it difficult to expand the organizations community activities. Treasurer recommended that alternatives be considered to transfer the Organization's operations to another not for profit organization, should the declining trends continue. After discussion among Board Members it was agreed that Sonia's comments were to be taken under consideration by the Board for further consideration and ultimate resolution.

For the minutes, dated February 13, 20XX, under the heading for Chief Executive's Report and hereby quoted:

"Treasurer reported that the number of individuals benefited by the Organization was continuing to decline 1,928 during 20XX to a projected number of less than 1,100. After discussion among Board Members it was agreed that Treasurer's prior recommendation that alternatives be considered to transfer the Organization's operations to another not for profit organization be taken under consideration by the Board at this time.

Therefore, Be it was resolved that to the extend feasible, any employees of the organization that could be given employment by CO-2 a 501(c)(3) should be allowed to seek employment with that Organization, and that a proposal for the ultimate transfer of the State clients presently being served by ORG be deferred as long as it is operationally feasible to continue serving any remaining clientele.

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For the minutes, dated May 25, 20XX, under the heading for Chief Executive's Report and hereby quoted:

"Treasurer reported that the number of individuals benefited by the Organization continued to decline to 987, a greater decline than anticipated.

...."

Board of Directors:

According to ORG's response dated May 23, 20XX, the current board of directors was as follows:

Treasurer- Managing Director/Secretary
CEO- Chief Executive Officer/President
BM-1- Director/Board Member
BM-2- Director/Board Member
BM-3- Treasurer/Board Member

Former Officer, Directors, and Key Employees included the following individuals:

Secretary- Director/Board Member
BM-4- Director/Board Member
BM-5- Director/Board Member
BM-6- Director/Board Member

ORG's related entities:

Treasurer is also the Managing Director and Secretary for CO-2 which provides debt management services to clients. Treasurer also owns a Subchapter S Corporation named CO-3.

Interview with Treasurer:

On June 6, 20XX, Revenue Agent interviewed Treasurer regarding ORG's activities. ORG was established with the main concern to serve its local clients in City. It was set up initially to manage clients' delinquent utility bills. ORG brought clients' payments to the local utility companies for the clients. However, ORG's service eventually evolved into debt management. As of July 20XX, ORG did not enroll any new clients. ORG maintains the existing debt management program (DMP) accounts for the existing clients who would eventually complete the DMP. ORG did not conduct any educational seminars and Secretary manages the daily operation of this entity.

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Number of clients and fees charged:

In ORG's response dated May 23, 20XX, it mentioned as of the beginning of the tax year 20XX, the number of clients was 2,245. During the year from January 20XX through July 20XX, 795 new clients were enrolled. For the entire 20XX year, 649 DMP clients were dropped off and 463 numbers of clients completed the DMP program.

In ORG's response dated November 13, 20XX, due to the change in the State Debt Management Law, the monthly client fees have increased to the greater of \$ or % of the amount paid to creditors each month. The previous client fees were \$ per month plus \$ per month per creditors placed on the DMP program. ORG also indicated that fees are reduced and or waived, based on the individual clients' ability to pay. The Service had asked for the number of clients whose fees were reduced and waived on its Information Document Request (IDR) #3. However, ORG's representative, BM-3 sent a correspondence to the Service on February 15, 20XX indicating ORG is willing to agree with an agreed revocation to expedite the examination process and therefore, ORG wants to avoid the need of responding to the Information Document Request #3 that was sent on February 12, 20XX.

Referrals:

ORG indicated on its May 23, 20XX's response that it did not utilize any lead providers for potential clients. ORG received referrals primarily from existing clients, community based organizations such as churches and corporations, in addition to the clients received as a result of direct mass media advertising. However, the Service was not able to request further information from ORG to verify the percentage of clients that ORG received from various sources as of the date this report is issued. ORG's representative, BM-3 sent a correspondence to the Service on February 15, 20XX, indicating ORG is willing to agree with an agreed revocation to expedite the examination process for closing and therefore, ORG wants to avoid the need of responding to the IDR #3 that was sent on February 12, 20XX.

Employees of ORG:

In 20XX, ORG had 28 employees who were Accountant, Accounting Assistant, Accounting Supervisor, Clerk, Counselors, Customer Care Representatives (CCR), and Technical Support. 10 of the 28 employees were identified as CCR and 9 employees were identified as Counselors and 1 employee as Counselor/Supervisor. In 20XX, the number of employees was downsized to 8 individuals. Some of the employees were transferred to CO-2.

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When asked for the Employee Handbook, ORG indicated it did not have any employee handbook and it followed the general guidelines of CO-2.

When asked for the employee training materials such as scripts used or job aids, ORG indicated it trained employees on one-to-one basis and therefore, did not use any scripts. It also utilized the training materials of CO-2.

Customer Care Representative:

In response to the Service's Document Request #1 for working experience, ORG provided a document indicating as Servicing Department and job description for Customer Care (Service) Representative (CCR). There was no job description for counselor.

The job description for the CCR is described as follows:

"Duties and Responsibilities:

Customer Care Representative (CCRs) are responsible for answering all incoming calls into CO-2 (CO-2) Call Center. The handling and managing of the client accounts includes all file maintenance, paperwork, and necessary computer adjustments. This position will be responsible for all inquiries from clients, creditors, and other satellite offices verbally via the telephone or through correspondence pertaining to their assigned position. Some inquiries may include research, which is, but not limited to, client assistance, calling the creditor, check research, review of the client database, and collaboration with other internal departments.

Skills and Abilities:

Qualified applicants will possess the followings skills and abilities:

- Great attitude and professionalism in Customer Service.
- Be able to communicate clearly and professionally via telephone.
- Knowledge and understanding of basic computer and office skills.
- Experience in problem solving, organization, and prioritization.
- Ability to do multiple tasks as given or assigned.
- Maintain composure while handling difficult customers and situations.
- Capability to perform necessary research to answer questions.
- Analyze information to determine the nature of communication whether it be a complaint, inquiry or service request.

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- Team and goal orientated.

Background requirements:

Educational Requirements:

- High School Diploma/GED, at least two years of College preferably.

Previous Work Experience:

- One to two years of work experience in an office environment.
- One year of Customer Service experience.
- Preferable work experience, six months in a Call-Center environment.

Knowledge:

- General understanding of credit cards and consumer lending, such as, annual percentage rates, monthly creditor statements, etc.
- Use of facsimile machine and photocopier.
- Excellent oral and written communications skills.

It was noted that the above job description is the same as the one used by ORG's related entity- CO-2.

Employee Performance Evaluation:

When asked for employee performance evaluation on the 28 employees which were employed in 20XX year, ORG indicated no formal evaluations were conducted since they only employed for a very short period. Revenue Agent reviewed the employees' files when she visited City, some of the employees from the 28 were hired in 20XX year but there were no evaluations for them in their personnel files.

Financial Data:

Revenue:

For the years under examination, CO-2 received its funding from the following:

| Category | 12/31/20XX | 12/31/20XX |
|---------------------|------------|------------|
| Revenue | | |
| Program Svc Revenue | | |
| Total | | |

For the years under examination, CO-2 incurred the following expenses:

| | | |
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| | 12/31/20XX | | 12/31/20XX | |
|--------------------------|------------|------------|------------|------------|
| Category | Amount | Percentage | Amount | Percentage |
| Wages and salaries | | | | |
| Advertising | | | | |
| Automobile | | | | |
| Office expenses/supplies | | | | |
| Rent | | | | |
| Travel | | | | |
| Others | | | | |
| Total Expenses | | | | |

Expenses:

Upon reviewing the available records that were provided, adjustments are made to the expenses for the following:

Automobile Expense:

CO-4 automobile:

Automobile expense on the lease for the CO-4 will be treated as wages to Mr. Secretary for the above two years. In ORG's response dated November 13, 20XX, ORG indicated and hereby quoted,

"...There was not a W-2 Form issued to Secretary, as the vehicles were used by Secretary, as well as other Counselors, Volunteers and directors whenever necessary. Secretary also provided the benefit to the organization by leasing the vehicle in his name."

The Service issued IDR #3 for the log sheets showing how the vehicles were used. However, as indicated above, ORG's representative, BM-3 sent a correspondence to the Service on February 15, 20XX indicating ORG is willing to agree with an agreed revocation to expedite the examination process for closing and therefore, ORG wants to avoid the need of responding to the IDR #3 that was sent on February 12, 20XX. Since the Service was unable to verify the proper use of the automobiles, the entire expense will be treated as wages to Secretary. ORG is responsible for the adjustment on its Form 941s for the years under examination. The amount of automobile expense for the 20XX year was \$ and for the 20XX year, the amount was \$. Please see attached report for the employment tax adjustment.

Other automobiles:

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For the year 20XX, ORG made auto payments to CO-5, Land Rover and DMV renewal for a total of \$. Since ORG did not provide supporting documents to substantiate the need of these vehicles for business purposes, an adjustment of \$ will be disallowed from the total expenses reported.

Printing and Reproduction:

The Service requested a list of six checks for sample review for verification of the expense incurred. However, as stated above, ORG's representative, BM-3 sent a correspondence to the Service on February 15, 20XX indicating ORG is willing to agree with an agreed revocation to expedite the examination process for closing and therefore, ORG wants to avoid the need of responding to the IDR #3 that was sent on February 12, 20XX. Since the Service was unable to verify the proper payments for the 20XX year, a disallowance of \$ for the checks numbered #, #, #, and # will be made to the total expenses unless ORG can provide evidence that these checks were for printing use for ORG since these checks were payable to individuals.

Educational Materials and Seminars:

For the 20XX year, ORG reported on its general ledger for a total amount of \$ for educational materials and seminars. The Service has requested a few of these checks to verify the proper expenses. However, as stated earlier, ORG wants to expedite the examination process for closing and hereby, agree with an agreed revocation without responding to the request. Since the Service was unable to verify whether the payments were for educational materials and seminars provided, the entire amount will be disallowed from the total expenses unless ORG can provide documentation to substantiate the expense.

Advertising:

For the 20XX and 20XX years, ORG paid \$ and \$ for advertising expenses. The Service has inquired ORG why it still incurred advertising expenses for these two years since ORG stopped enrolling new clients as of July 20XX. ORG did not provide its response because it wanted the Service to expedite the examination process for closing as mentioned above. Since the Service was unable to verify the reasons for the advertising, a partial disallowance of a total of \$ for the year 20XX and the entire advertising expense of \$ for the year 20XX will be made to the total expenses claimed for these two years.

Travel:

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For the two years, ORG reported on its general ledger for the amounts of \$ for the 20XX year and \$ for the 20XX year. The Service had inquired for documentations for the travel incurred for the 20XX year. However, ORG did not respond due to the reason mentioned above. Since the Service was unable to verify the travel expenses, these amounts will be adjusted from the total expenses reported.

Rent:

For the two years, ORG reported on its general ledger for the amounts of \$ for the 20XX year and \$ for the 20XX year. . The Service had inquired for documentation as to why ORG needed three locations to operate since it did not enroll any new clients as of July 20XX. The Service also requested for a list of employees who worked at these locations and their job duties. However, ORG did not respond due to the reason mentioned above. Since the Service was unable to verify the reasons for these three locations, a disallowance of the two locations will be made to rents that were paid to the Address and the Address. The total adjustment for the 20XX year is \$ and \$ for the 20XX year.

The total adjusted expenses are as follows:

| Adjustment for the years: | 12/31/20XX | 12/31/20XX |
|--------------------------------|------------|------------|
| Total expenses reported | | |
| Adjustments: | | |
| Automobiles | | |
| Printing | | |
| Educational Materials/Seminars | | |
| Advertising | | |
| Travel | | |
| Rent | | |
| Total adjusted expenses | | |

The revised net income or loss is computed as follows:

| Category | 12/31/20XX | 12/31/20XX |
|-------------------|------------|------------|
| Revenue | | |
| Adjusted expenses | | |
| Net income/loss | | |

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Bank statements:

ORG maintained the following accounts as of the end of each tax year under examination. The account balances shown on the bank statements for these accounts were as follows:

| Account | Number | Type | Balance as of 12/31/05 |
|---------|--------|------------------------|------------------------|
| CO-6 | | Administrative Account | |
| CO-7 | | Trust fund | |

Law:

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(4) is exempt from income tax. The Code defines Section 501(c)(4)(A) as Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. Section 501(c)(4)(B) states that Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Income Tax Regulations section 1.501(c)(4)-1(a)(1) defines civil organizations as a civic league or organization may be exempt as an organization described in section 501(c)(4) if (i) it is not organized or operated for profit; and (ii) it is operated exclusively for the promotion of social welfare.

Income Tax Regulations section 1.501(c)(4)-1(a)(2) defines promotion of social welfare as (i) in general, an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embrace within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of Section 1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of Section 1.501(c)(3)-1.

Income Tax Regulations section 1.501(c)(4)-1(a)(2)(ii) states that the promotion of social welfare does not include direct or indirect participation or intervention in political campaign on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is

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carrying on a business with the general public in a manner similar to organizations which are operated for profit.

The Service has issued a revenue ruling holding credit counseling organizations to be tax exempt under IRC 501(c)(4). Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts." The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

In Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F.2d 684 (2d Cir. 1973), cert. denied, 419 U.S. 827, 685, 687 (1974), the Court of Appeals held that an organization assisting member plumbers in their profession by repairing the cuts they made in city streets was not exempt under section 501(c)(4). The court concluded the organization was not primarily devoted to the common good because it provided substantial benefits to its private members that were different than those benefits provided to the public.

Rev. Rul. 86-98, 1986-2 C.B. 74 stated that benefit to members does not qualify an organization to be exempted under Internal Revenue Code (Code) 501(c)(4). In this ruling, the IPA (individual practice association) negotiates agreements with HMOs on behalf of member physicians under which its members provide medical services to HMO member patients. The agreements also require the IPA to perform necessary administrative claims services. The ruling concludes that the primary IPA beneficiaries are its member-physicians rather than the community as a whole. The IPA benefits member-physicians by functioning like a billing and collection service, and a collective bargaining representative for them. Moreover, the IPA does not benefit the community by providing HMO patients access to otherwise unavailable medical care, and does not provide care below the customary and reasonable charges of members in their private practices.

Taxpayer's Position:

ORG's position has not been determined.

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Government's Position:

The Service contends that ORG has a more than insubstantial nonexempt purpose. ORG provides its DMP service as the only activity to its existing clients. As of July 20XX, ORG stopped enrolling new clients. For the years under examination, ORG did not perform any educational activities to these clients but maintained their DMP accounts administratively. Therefore, its exemption status should be revoked.

ORG's total source of funding was from fair share contributions and client fees. ORG did not receive any private or governmental grants for the years under examination. ORG had completely relied on the creditors' fair share and client service fees for its operation.

The contribution amounts solicited from the existing DMP clients are not charitable gifts or donations. They are fees for services and ORG may have misled its clients into claiming contribution deductions in which they are not entitled to.

ORG was not primarily devoted to the common good because it provided substantial DMP benefits to its clients. ORG's clients are a selected group of individuals who must meet the criteria set by the participating creditors. ORG is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

For the earlier years which ORG still enrolled DMP clients, its employees had no performance evaluations in their personnel files or evidence showing they continuously receive training on how to develop options and recommendations for the incoming callers. There was no evidence or plan for the development of skills for the counselors to identify underlying personal problems of the callers so they can make appropriate referrals for the callers.

As confirmed with ORG's officer, Treasurer, ORG did not provide any educational outreach activities for the years under examination. ORG's board comprised with five individuals of which two members are family members and it is not a community-based board.

Conclusion:

In summary, ORG was not operated exclusively for tax exempt purpose, because it did not engage primarily in activities that accomplish an exempt purpose and more than an insubstantial part of ORG's activities are in furtherance of a non-exempt purpose. Accordingly, it is determined that ORG is not an organization described in section 501(c)(4) effectively January 1, 20XX.